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IN THE

Supreme Court Of the United States

OCTOBER TERM, 1967

No. 1

[redacted]

Petitioners,

vs.

[redacted]

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

[redacted]
[redacted]
WILLIAM DUNCAN

[redacted]

EDWARDS, BELK, HUNTER & [redacted]
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ATTORNEYS FOR PETITIONERS

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IN THE

Supreme Court of the United States

October Term, 19____

No. _____

LEAVELL & PONDER, INC., and MORGAN COMPANY, INC.,

Petitioners,

versus

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above case on January 23, 1961.

CITATION TO OPINION BELOW

The opinion of the Circuit Court of Appeals, printed in Appendix A hereto, pages A1-A25, is reported in 286 F. 2d 398.

JURISDICTION

The judgment of the Circuit Court of Appeals was dated and entered on January 23, 1961 (Record, page 1096). Rehearing was denied on March 7, 1961 (R. 1130). The jurisdiction of this Court is invoked under 28 U.S.C.A. 1254(1). The jurisdiction of the Trial Court was invoked under Acts shown in Appendix D hereto, page A28.

QUESTIONS PRESENTED

1. Whether the Trial Court exercised sound discretion in referring this case to a commission, under Rule 71-A, Federal Rules of Civil Procedures, for the determination of just compensation on the taking of the Wherry Housing projects.

2. Whether the original cost of the project is admissible as proof of value of the condemned property, if reproduction cost is held inadmissible as proof of value of the property.

3. Whether the three alternative methods of computing value, as employed by the Commission for determination of just compensation, were supported by substantial evidence and not clearly erroneous.

STATUTES INVOLVED

The housing projects here condemned were required to be condemned under the terms of the Capehart Act, 42 U.S.C.A. 1594(a). The projects had initially been created under terms of the Wherry Act, 12 U.S.C.A. 1748. (Quotation of statutes, Appendix E hereto, page A29).

STATEMENT

Petitioners were owners of two identical Wherry Housing projects, being some 400 dwelling units in each project and a shopping center, located on 124 acres of government owned land at Ft. Bliss, Texas. By this suit, the United States condemned the leasehold, improvements and all title and interest of Petitioners. The Trial Court referred the determination of just compensation to a commission (R. 33), and when the United States excepted (R. 35), the Trial Court heard testimony and argument (R. 46-74), and received briefs from the parties, and ordered again that a commission determine just compensation (R. 37).

The Commission heard testimony for two weeks, beginning January 5, 1959 (R. 211, **et seq.**), thereafter received the briefs of the parties and the transcript of all evidence, and on October 2, 1959, filed its Report and Findings (R. 152-160), reciting its evidentiary findings, making three alternative calculations of value, and stating a conclusion of fair market value of the property (the conclusion being the lowest of the three calculations). The Trial Court, on motions and hearing, approved and adopted the report of the Commission and entered judgment that Petitioners recover compensation and interest (R. 190).

On appeal by the United States, the Circuit Court of Appeals reversed and remanded the action, by opinion filed January 23, 1961, (R. 1096), which held the Commission's report not to be based on evidence, and which ordered trial "in the conventional form by a jury" (R. 1120). Rehearing was denied on March 7, 1961 (R. 1130).

REASONS FOR GRANTING THE WRIT

FIRST. The decision of the Circuit Court of Appeals in this case, holding that "on the record it was error for the trial court to make such reference" to a commission (R. 1117), is directly in conflict with other holdings of said Court and other circuit courts, and with the letter and purpose of Rule 71-A, Federal Rules of Civil Procedure, 28 U.S. C.A. The decision in this case completely vitiates the discretion of a trial court to look at the character of the property condemned, and the nature of the appraisal problem involved, and then refer the case to a commission to determine just compensation. If the character of this property does not justify use of Rule 71-A, then a trial judge actually has no discretion to use the Rule.

In this case, the Trial Judge heard testimony, argument and briefs which described the nature of the property and the complications inherent in evaluation (R. 46-74), as well as a study of the intricacies shown by the transcript of a recently tried Wherry case (R. 38) (being the "Chanute

case", on which later opinions were published as **United States v. Certain Interests,** 165 F. Supp. 474, E. D. Illinois, and 271 F. 2d 379, 7th Circuit). The Trial Court anticipated that the character of the property would require evidence for evaluation more difficult than a jury could handle, and the entire record here shows that the oral testimony was lengthy and was involved with figures, projections and percentage rates, that 120 exhibits were introduced, and that the determination of compensation required a grasp of F. H. A. regulations, leases and other instruments, and such matters as a jury could not be expected to evaluate in a few hours in a jury room. The Commission did not attempt to reach an evaluation until the testimony had been transcribed and studied at length in reaching its conclusion.

The property here involved is the very kind of property that a trial court should have discretion to refer to a commission. The Court below has recently held that evaluation of property no more complicated than this can be referred to a commission, in a trial court's exercise of discretion, **United States v. Buhler,** 254 F.2d 876 (5th Circuit), and such holding is in conflict with the instant holding. The instant holding is in conflict with the discretion explicitly given in Rule 71-A itself. The instant holding is in conflict with holdings of other Circuits allowing the discretion of the trial court in using the Rule where the character of the property indicates, as here, that a commission would be appropriate: **United States v. Delaware, Lackawanna Ry.,** 264 F.2d 112 (3rd Circuit); **Cunningham v. United States,** 270 F.2d 545 (4th Circuit); **United States v. Wawmire,** 202 F.2d 550 (10th Circuit). The Courts have held that a broad discretion was intended by Rule 71-A to be vested in the trial court, to choose between the use of a jury or a commission. **United States v. Chamberlain,** 226 F2d 492 (8th Circuit); cert. den., 350 U.S. 989, 100 L. Ed. 855; and see 7 **Moore's Federal Practice** (2nd ed.) 2787, sec. 71.90, and 3 **Barron & Holtzoff, Federal Practice** (1958) 565, sec. 1525. Congress, after date of this taking, legislated that commissions may be used in Wherry cases, 42 U.S.C.A. 1594(c)1.

For the Circuit Court to say that the Trial Judge "did not make any finding" to support the reference to the Commission (R. 1118), and to say that elimination of reproduc-

tion cost as an appraisal approach so simplifies this case as to make it a jury case (R. 1118), is to take a completely unrealistic view of the record in the instant case and the history of the Wherry housing litigation to the present time.

SECOND. In destroying the discretion of a trial court to make reference to a commission in a case involving such property as this, the Court below has departed from the usual course of judicial proceedings and has nullified the clear purpose of Rule 71-A. In the litigation resulting from the condemnation of Wherry projects under the Capehart Act, the opinions already reported show that while the condemnor customarily demands a jury, some trial judges have considered that the cases should be referred to commissions, **Buena Vista v. United States,** 281 F.2d 477 (10th Circuit, from District of New Mexico), and **United States v. Bragg Investment,** 185 F. Supp. 555 (E. D. North Carolina), while other judges have decided the contrary, **United States v. Corbetta-Price,** 176 F. Supp. 603 (N. D. Illinois, E. D.), and two or three other Wherry cases have been tried to a jury where apparently both the condemnor and the owner asked for a jury. The discretion of a trial judge to refer, or not refer, such a case as this to a commission should not be destroyed, and the holding of the Court below in this case calls for an exercise of this Court's power of supervision.

THIRD. This Court is also called upon to exercise its power of supervision because the holding of the Court below attempts to establish an erroneous rule of evidence for Wherry condemnation cases. The error is this: Holding that the cost of the project at the date it was built, 1950, is proof of value even though the cost of reproduction of the project at the date it was condemned, 1958, is not proof of value. The holding is in this language (R. 1119):

> Proof of value must be of three kinds: (1) The cost of the project -- a single total figure easily testified to before a jury: . . . .

The Court below had already apparently said this in its opinion in **United States v. Benning Housing,** 276 F.2d 248 (certiorari petitioned, we understand, but not pursued), when it said, page 253, that

> the case must be tried on the basis of comparable sales, capitalization of income and original cost.

(This was quoted in the instant opinion, R. 1116). The **Benning** opinion eliminated reproduction cost as a measure of value, yet sought to retain original cost as a measure of value. This position is reiterated in the instant opinion.

Yet, "original cost is entitled to less weight than reproduction cost", 2 **Orgel on Valuation Under Eminent Domain,** (2nd Edition) 86, section 209, the original cost being only a measure or check upon current reproduction cost, page 87.

Further, the United States recognized in the instant case that the Court below erred in retaining original cost as evidence of just compensation where reproduction cost had been eliminated. In its main brief, the United States said (page 62):

> Original cost as direct evidence of value should be inadmissible for the reason that the cost of reproduction is excluded. It is relevant, however, to the income available and also to depreciation expense. This was, we believe, the meaning of the reference to original cost in the **Benning** opinion (p.253).

The Court below erred in attempting to eliminate reproduction cost but retain original cost as evidence of value. In attempting so, and in leaving certain stated factors to be admissible, the Court below attempted to create a unique rule of evidence for evaluation of property in Wherry con-

demnation cases, and said in **Benning** (p 253) that "the problem of valuation on the basis of these factors alone is a difficult one", yet said in the instant case that the problem was simple enough obviously to be submitted to a jury for decision. The Court below has attempted to reduce this evaluation to certain factors, a formula, or inexorable rules, and this cannot be done. **United States v. Toronto,** 338 U.S. 396, 94 L.Ed. 195; **United States v. Cors,** 337 U. S. 325, 93 L. Ed. 1392.

FOURTH. A commission's finding of value, within the range of sharply conflicting evidence, is conclusively binding on an appellate court, where based on substantial evidence or unless clearly erroneous. **Buena Vista v. United States,** 281 F. 2nd 476 (10th Circuit). In conflict with this typical holding, the Court below in the instant case held that the alternative calculations and the finding of the Commission on value should be set aside. Yet, the calculations and finding were within the range of evidence and supported by ample evidence. The testimony of professional appraisers ranged from one half million to nearly three million dollars as just compensation, and the elements of projected income, expense, economic life, capitalization rate, etc., varied widely. The significance of the sale of half ownership of the projects in 1953 was sharply conflicting, and both the Owners and the Government presented and urged evidence relating to that sale as a measure of the value of the projects at the date of taking. On this large record, the Commission made three calculations of value, and stated the lowest of the three as its finding of fair market value: (1) The value of the property as indicated by the sale of one half the projects in 1953; (2) the value as indicated by a capitalization of projected income, disregarding the impact of income taxes; (3) the value as indicated by a capitalization of projected income, taking into consideration the impact of income taxes as a market influence. These calculations and the finding of fair market value were not clearly erroneous, but on the contrary were supported by the evidence and represented the vast labor of a highly competent Commission to find the market value of the condemned property. Therefore, the decision of the Court below is thought to be wrong.

FIFTH. The writ should be granted because of the importance of the questions in this case to the Wherry condemnation litigation now in progress, and to the field of federal condemnation law, generally. The opinion below has ruled upon important questions which have not been, but should be, settled by this Court; namely, whether Rule 71-A can be nullified by a holding that a trial court may not, in his discretion, refer such a complicated property and difficult evaluation problem as this to a commission; whether cost of a property must be shown as evidence of value, when reproduction cost may not be shown; and whether the findings of the Commission in this case are supported by substantial evidence and are not clearly wrong.

There are many Wherry condemnation cases now pending, and several have already been reported in the Federal Supplement and Federal Reporter (listed in Appendix B, page A 26). The legislation relating to the projects and their taking foreshadows that many more cases are to come. This is an important body of litigation, and the questions involved in the instant case should be decided by this Court.

CONCLUSION

For the foregoing reasons, Petitioners pray that this petition for writ of certiorari be granted.

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CERTIFICATION

Eugene T. Edwards, one of Counsel, hereby certifies that the foregoing Petition for Writ of Certiorari is made in good faith, that in his opinion there are good grounds for same, and that such petition is not filed for delay; further, that on April 22, 1961, four copies of said petition were mailed, with first class air mail postage, to Mr. Perry W. Morton and Mr. Robert McKee, Attorneys, Department of Justice, Washington 25, D. C., and two copies to Solicitor General, Department of Justice, Washington 25, D. C.

Eugene T. Edwards

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 18427

UNITED STATES OF AMERICA,
Appellant,

versus

LEAVELL & PONDER, INC., and MORGAN COMPANY, INC.,
Appellees.

Appeal from the United States District Court for the Western District of Texas.

(January 23, 1961.)

Before TUTTLE, Chief Judge, and RIVES and JONES, Circuit Judges.

TUTTLE, Chief Judge: This is an appeal by the government from an award in a condemnation of a Wherry Housing Project. The matter was originally referred by the trial court to three commissioners as authorized by Rule 71(a), Federal Rules of Civil Procedure. The

findings of fact and conclusions of the commissioners were accepted in full and adopted by the trial court.

The principal grounds of the government's appeal are: (1) the commissioners made a finding of value based on evidence of a prior sale of part of this same property, whereas such prior sale was not for cash or its equivalent, but was for part cash and part exchange of real estate, and as to the real estate no proper appraisal was made to support the value assigned to it by the parties to the transaction; and (2) in making a finding of value based on the capitalization of anticipated income from the property the Commission utilized a 4-1/2% rate of return which was unrealistic and without support in the evidence; and (3) in making a further finding of value based on capitalization of income after a deduction for corporate income taxes the Commission made improper assumptions, departed from accepted principles of valuation in taking income taxes into consideration, and utilized a 2-3/4% ratio of return which was unrealistic and without any evidentiary support in the record.

The property condemned comprised leasehold interests in some 124 acres of government owned land within the Fort Bliss Military Reservation at El Paso, Texas. There were two practically identical developments, one owned by each of the two corporate appellees. Both projects combined were known as Van Horne Park. The leasehold interest had been improved by the construction by each of the sponsors of some 400 dwelling units and by the joint construction of a shopping and trade center.

The characteristics and nature of a Wherry Housing Project have been fully discussed by this Court in *United States v. Benning Housing Corporation*, 5 Cir., 276 F.2d 248, and by the Court of Appeals for the Tenth Circuit in *Buena Vista Homes, Inc. v. United States*, 10 Cir., 281 F.2d 476. In the *Benning Housing* case we said:

> In order to evaluate the contentions as to rent control, a brief survey of the background of these projects seems necessary. The projects were constructed under the aegis of the Wherry Act, which was enacted on August 8, 1949, in an attempt to relieve an acute shortage of housing which existed at that time at military installations throughout the country. The Act envisioned the construction of this needed housing by private builders and its provisions were consequently specifically designed to remove what appeared to its chief proponents to be the major impediments to such construction. The then current view of the problem was concisely expressed by Senator Wherry himself:
>
> > There are three requisites that must be provided in this legislation if it is to be successful: The program must be attractive to the mortgage banker who supplies the money; the project must be made attractive to the Federal Housing Authority to enable it to set rental prices within the reach of families in the lower income brackets as well as in the higher brackets. [S.Rep. No. 231, 85th Cong., 1st Sess., at p. 11.]

The Wherry Act proposed to meet these requisites by providing for: (1) the elimination of

land and acquisition costs by the leasing of land on military installations on long-term, irrevocable leases at nominal rentals; (2) a special form of mortgage insurance which avoided the problem created by the fact that ordinary F.H.A. mortgage insurance was unavailable because of the risk involved by reason of the location of the needed housing and the question as to the permanent nature of the military installations; and (3) F.H.A. control over the rents which could be charged for housing constructed under this plan.

Considered in the light of the purposes of the Wherry Act, the proper resolution of the controversy seems clear. The condemnees' argument rests squarely upon a basic misconception of those purposes. For condemnees presuppose that the inducements offered by the Wherry Act to stimulate building, i.e., leases at nominal rentals and Government-insured mortgages, were outright gifts to the Wherry sponsors and for which the Government would not, and, indeed, could not, exact a return. Such is not the proper interpretation of that Act. These inducements were offered in return for lowcost housing. It is clear that the policy has consistently been one of allowing a return based upon original cost rather than reproduction. Rent increases were sanctioned only to offset rising operating costs and not to compensate for increased reproduction costs. The Act did not contemplate that sponsors would recover reproduction costs on a sharply rising market. And there was nothing unfair in its failure to do so. By insuring the mortgages on the projects, the Government assumed the risk of loss on a de-

clining market. In such a situation, respect for the public interest practically required that no benefit should accrue to the sponsors as a consequence of inflation. [276 F.2d 248.]

It should be added to this that the sponsors were also subject to regulations relating to methods of operation of the housing.

The housing projects here sought to be condemned were required to be condemned under the terms of the Capehart Act, 42 U.S.C.A. §159 a(b). Under this Act before the Federal Government could undertake to build similar housing on military reservations, it was required to acquire title to the Wherry projects. Construction on the Van Horne projects began on March 1, 1950, the first units were occupied on July 22, 1950, and all units were completed and occupied by April 15, 1951. The total cost of construction of each of the two units was $3,400,400.00.[1] The original mortgage was for $3,316,000.00.[2] Under the terms of the law the owners were permitted to and did receive rentals on the units without any obligation for mortgage or interest payments until September, 1951. Such rentals amounted to a net sum of approximately $100,000.00 for each project.

---

[1] The commission treats each unit separately in connection with its findings which we discuss hereafter. Unless otherwise indicated, therefore, items of cost, income and valuation will relate to one of the units.

[2] The Government's reply brief calls attention to the fact that there was an additional commitment of $247,500 for each project to construct the shopping center. The briefs do not make clear whether the total cost of construction given above includes the cost of constructing the shopping center.

The declaration of taking by the government was accompanied by a deposit of $291,000.00 for each property. The commission found that the correct value was $977,266.47. The duty facing the commissioners was to make findings of fact and arrive at conclusions based on such findings fixing the fair market value of Van Horne Park, taking into consideration all of the facts and circumstances that would reasonably go into the making of a bargain of purchase and sale between a willing buyer under no obligations to buy, and a willing seller under no obligations to sell. *Messer v. United States*, 157 F.2d 793. *Gwathmey v. United States*, 215 F. 2d 148.

We have held that in a condemnation of Wherry Housing projects the means of proving such market value may not include proof of reproduction cost less depreciation. *United States v. Benning Housing Corporation, supra.* In that case we stated that the means of ascertaining fair market value in such a case as this must be "on the basis of comparable sales, capitalization of income and original cost."

The commission heard considerable testimony as to reproduction costs of these projects. It expressly held, however, that this should not be considered in arriving at its determination of value. Its determination resulted from computations which it made after making certain findings of fact as an aid in arriving at a valuation by capitalizing projected net income. The commission's findings of fact and conclusions resulting from such findings were as follows:

> As a basis on which to arrive at the Owner's loss, the Commission in its deliberation has

projected the income of the owners to the end of the considered economic life of the properties, fifty years, less 7 years passed, and has taken into consideration, as to interest paid on the mortgage, only the diminishing annual interest payments to date of the mortgage's complete liquidation, and finds the Owner's potential net gain to be $6,615,341.38, for each one-half of the project. The present value of $1.00 at what the Commission finds to be the proper interest rate of 4-1/2% (4% F.H.A. mortgage insurance, plus 1/2% mortgage insurance) compounded annually for 43 years, for each one half is $996,670.91, which sum, we find to be the Owner's loss.

The Commission has further considered the fact that if the purchaser of such property were a corporation it would pay an income tax of 52%, after giving credit for an exemption as provided by law for the first $25,000.00 in income each year exempt from the surtax. The projected income above shown $6,615,341.38, less the calculated income tax leaves a balance of $3,411,863.86, which the Owners could have expected to take home after taxes. The Commission has then used this figure and considered it as "non-taxable" income to ascertain what a prudent buyer would be required to invest in non-taxable securities to obtain the above figure. It is the Commission's opinion that an earning rate of 2 and 3/4% would be proper, and it has therefore reduced such net "non-taxable" income to a "present value" using published tables as heretofore stated and arrived at the Owner's loss of $1,062,607.75, for each one-half of the property.

Had this property been purchased by an individual rather than a corporation, it is reasonable to assume that he would be a person of considerable wealth and income and that his income tax would equal or exceed the corporation rate of 52%.

• • • •

The Commission, in view of the foregoing considerations and findings, has arrived at a determination of the value of the loss to the Owners, by virtue of the taking of the Van Horne Park as follows:

(a) Loss sustained (one-half of project) by using net income projected over economic life of improvements, before income taxes, reduced to present value.

$996,670.91.

(b) Loss sustained (one-half of project) by using net income projected over economic life of improvements, after Federal Income Taxes, reduced to present value, the income being used as "non-taxable".

$1,062,607.75.

Having made such findings and conclusions, the commission then arrived at a third conclusion of value, which is the one it fixed as the amount of the award. This conclusion was:

(c) Value of consideration of sale of Morgan Company, one-half interest to Ponder Interests, $940,000.00 adjusted for subsequent mortgage annual retirements, and diminished by sustained economic depreciation, and including cash consideration of $172,000.00.

$977,266.47.

The finding of fact to support this conclusion was the following:

> SECOND: The Commission finds that the sale of the Morgan Company's one-half interest in the Van Horn project is worthy of consideration and weight in arriving at the fair market value as viewed by a willing seller and a willing buyer, without duress. The testimony of Mr. Ponder and Mr. Morgan has been accepted as that of competent local investors, to the value of the assets exchanged in the transaction, stated to be at $900,000.00 and $940,000.00, respectively. All evidence in regard to this transaction has been carefully considered.

The consideration of the evidence relating to this transaction is one of the matters sharply criticized by the United States. Careful analysis of the transaction convinces us that this criticism is well merited.

In 1953 appellee Morgan Company, Inc. was a corporation owning one of the two projects constituting Van Horne Park. Its stock was all owned by the Morgan family who desired to sell it to Dan R. Ponder, Inc., owned by Dan R. Ponder. A deal was worked out and a written contract was executed in which the entire Morgan Company stock, representing the ownership of the housing project was sold to Ponder. The contract provided that Ponder had the option of paying $217,000 cash or $172,000 cash, 10.34 acres of land in fee and transfer of options to purchase a tract of 50.93 acres and one of 10.34 acres of land. Ponder actually paid $172,000 cash and transferred the land and options as payment of the purchase price.

Clearly, if this contract correctly stated the terms of the agreement between the parties, then Morgan, Inc. was bound by a contract to sell its project to Ponder for $217,000. Such Contract, even though made some five years before the taking would be relevant evidence for the commission to consider in determining fair market value on this condemnation procedure. This would be true because it would represent an arm's length transaction between two persons neither under compulsion. Changes in land or construction values in the interim would not affect the value because all the purchaser would be buying in any event would be the equity value in a leasehold which was shown by the evidence to be producing the same net income during the intervening years. When the government made its payment into court on the filing of its declaration of taking, it doubtless laid great stress on this apparent sales price of 217,000. Such estimate of value was doubtless further bolstered by the fact that the Ponder and Morgan interests all reflected this $217,000 value on their income tax returns for the year 1955, and the assumption that such return spoke the truth, or, at least, made it impossible for the parties to contend for a higher value as of that time. Not only did Ponder, Inc. pay a tax on the declared value of $45,000, since this was a taxable exchange, but on the deed to the 10.34 acres transferred in fee it placed $33.00 in stamp taxes, representing its value to be $30,000.00.

Any such theory of the Government, however, was shattered when Ponder took the stand in this proceeding and testified that the land and options which he had

represented on his company's books and 1953 income tax return to be worth $45,000 *was really worth at that time* $900,000.00, *twenty times as much* as reported for tax purposes. The 10.34 acres that bore stamps showing a value of $30,000 he testified was worth $563,000. Then, having claimed that the real consideration for the trade was not $45,000, as reported for income and stamp tax purposes, but was $900,000, Mr. Ponder, as a witness, said this still represented only part of the real value of the property at the time of the taking—that the true value which he should receive was $700,000 more, or $1,600,000.

The commission, as shown above, credited Ponder's testimony to the penny as to the value of the project in 1953, and its award was the exact amount of this valuation, after adjustments, which were purely mathematical adjustments not affecting value.

The government complains on two principal grounds. Basically, it says, it is improper for the condemnation court to consider transfers of the same or comparable property as a standard of value unless the sale is for cash or its equivalent (such as notes secured by the land or the like). This is to say, in the process of valuing tract A (Van Horne Park), which is the matter before the court, the court cannot consider a sale or exchange of tract A at an earlier date if such transfer is made partially for cash and partially for tracts B and C. In support of this contention the United States cites: *Jefferson Park Dist. v. Sowinski*, 336 Ill. 390, 168 N.E. 370 (1929); *Goodman v. Bethlehem*, 323 Pa. 58, 185 Atl. 719 (1936); *Fort Worth Improv. Dist. No. 1 v.*

Weatherred, 149 S.W. 550 (Tex. Civ. App. 1912); *Oregon R. & Nav. Co. v. Eastlack*, 54 Ore. 196, 102 Pac. 1011 (1909).

The Illinois court in the Jefferson Park District case said: "To render evidence of sales competent they must be for money, and not, in whole or in part, by way of exchange." 168 N.E. 370, 371. This case cited as authority the earlier decision in *Sanitary District v. Boening*, 267 Ill. 118, 107 N.E. 810.

In *Goodman v. Bethlehem, supra*, the Pennsylvania court said, in ruling out testimony as to what the condemnee had paid for the property: "The testimony indicates that the property was purchased not for cash, but was traded in for other real estate; this situation would have necessitated an investigation into the values of these other properties which would undoubtedly have been confusing to the jury." 185 Atl. 719, 724

The United States also refers us to *Hannah v. United States*, D.C.Cir., 131 F. 2d 441, in which the Court affirmed the refusal of the trial court to receive evidence of an earlier offer for the same property saying, "The consideration offered consisted in part of the property and, consequently, involved collateral issues concerning its value."

We think the facts of this case are a clear demonstration of the inherent weakness of the evidence of prior sales of the property in question unless they are sales for cash or its equivalent. Here the court is concerned with the valuation of tract A (in the above illustration).

Hundreds of pages of testimony were given touching on this issue, yet the commission found as the value the exact amount the parties testified was paid by Ponder for the Morgan half. But this testimony was based on certain assumptions as to the values of tracts B and C which were transferred as part of the exchange. These assumed values of tracts B and C were treated so casually as to be absolutely meaningless in a search for the true value of the project. They amounted to nothing more than the extremely self-serving contradictory testimony of the parties that what they reported for purposes of fixing their income tax and stamp tax liability was worth $45,000, was really, in their unsupported opinion, worth $900,000. None of the sifting and testing which all parties recognize must precede the acceptance of opinion evidence of value in the case of tract A was carried out with respect to tracts B and C. As a result, all the inquiry that was made and all the testimony of the qualified experts on value after full sifting and testing was cast to the winds by the commissioners when they accepted this evidence touching on the sale price of the Morgan tract as fixing the value for condemnation purposes.

The second ground on which the government complains is that the condemnees, themselves, in arguing the case to the commission, took the position that proof of the Morgan sale at $977,266.47 was not relevant evidence on the issue to be decided. They took this position on the very ground that the government is now urging it, that is that the sale was not for cash but was an exchange of properties. Of course, they took that position before the commission because they were then claiming a value of $700,000 *more* than they

were now testifying was the correct sales price in 1955. But, whatever their purpose, they took the position that proof of the sale was irrelevant, and the government contends that they should be bound by that position.

Here, however, the appellees contend that the government itself is not in a position to object to the consideration of the evidence of this sale because the government took the deposition of Mr. Morgan relating to the sale in preparation for the trial and indicated that they were planning to rely upon proof of the sale of the Morgan tract. This overlooks completely the basis on which the government had a right to use the sworn facts relating to the earlier sale as an admission against interest by Ponder, one of the parties to the condemnation proceedings. The contract on its face showed that the Morgan interest was valued at $217,000. The government had a right to introduce that contract in evidence in an effort to prove an admission limiting its value to that figure. This would be clearly admissible because the contract expressly stated that Ponder had the privilege of paying cash for the property. There would thus be no question as to an exchange of properties. No such correlative right could be the basis of the condemnees' proof that the sale had actually been made at $900,000 by exchange of properties. Because of the final disposition which we make of this case we do not decide whether it was error to admit the evidence of the Morgan sale. We have no doubt of the government's right to introduce the contract if it desired to do so in an effort to show an admission against interest. We think that in spite of the inconsistency of

the proof of value, hereinafter discussed, the condemnees have the right to show that the $217,000 figure did not represent the true consideration.

We next deal with the inconsistent position taken by the witnesses Ponder and Morgan here when compared with their action in filing their income tax returns in connection with this sale. While we cannot say the evidence touching on this matter was wholly valueless on this ground, we discuss it to indicate how such collateral issues, when brought into the case, might be extremely confusing to a jury or other fact finder unless strictly controlled by application of recognized rules of evidence. This inconsistency is in the nature of the testimony dealing with the action of the parties to the Morgan transaction. The reason given by the accountant witness, Martin, for drawing up the contract of sale of the Morgan half in the form of an option to pay $217,000 cash or to pay $172,000 and land worth $45,000 shows that a palpable fraud on the government was committed if the present testimony of Ponder and Morgan is to be believed. Martin testified: "Phrasing it slightly differently, in 1953 there was a technical realization of gain under the Internal Revenue Code, but there was no money. What the parties wished to do was to defer the maximum amount of tax until such time as they got the money with which to pay the taxes."[3]

[3] This is euphemism for saying, "On this exchange of properties a tax was due, but the parties elected to pay the tax on only a part of their gain and to postpone the rest of it until it was more convenient for them to pay it,"—a clear and intentional violation of the tax laws to the extent that the true gain was not computed on a correct valuation of the property.

Martin said that although he knew the sale was a taxable exchange and that property received and given in exchange must be reported *at its fair market value,* the parties, with his knowledge, "reach[ed] up in mid-air and pull[ed] down a figure—any figure they wanted to," and that is what they reported for income tax purposes. He said that he told the parties they could put on their books the "lowest value of the land which results when it is appraised as being used for, let's call it the *cheapest type of use* feasible or *possible* to put the land to," and that he was then faced "with a problem of how to make this *arbitrary* evaluation that had been used by the parties, how to make that acceptable to the Internal Revenue Service upon an examination of the applicable income tax returns, and this option to pay cash on the part of Ponder's part, the option on the part of Ponder to pay—yes, the option to pay $172,000 cash and the real estate rights or to pay $217,000 cash was put in there in an *attempt to buttress the evaluation used when the tax returns were examined by the Internal Revenue Service.*" (Emphasis added.) It was then testified to by Ponder, "It was understood from the outset that the Morgans would get the land and we were to get the stock." He testified, "Never at any time did I consider that I had [the] election [of paying $217,000 in cash]."

As plainly, therefore, as the parties could say it, these witnesses testified on the trial of this present case that they had put a "job" over on the Internal Revenue Service by making it appear that Ponder could buy the Morgan property for $217,000, but this figure

was just a sham, put in to cut down the income tax, and that there was a side agreement that Ponder could not pay the cash but must transfer the property. This property, they say, was really worth something over $1,000,000 at that time and they should not be stuck with the figures they had reported on their income tax return. We think the most charitable thing that can be said of this argument and of this testimony is that being contrary to the previous statement of the witnesses in a matter requiring the utmost accuracy, either the representations to the government on the tax returns were false or this present statement of the value in 1953 is false, and acceptance by the commissioners of the present testimony at its full face value amounts to a finding that the parties to the Morgan sale deprived the government of the income tax for 1953 on a gain of some $900,000.

We do not need to hold that this glaring inconsistency alone prevents this testimony from amounting to substantial evidence in order to set aside the finding of a valuation of $977,267.47 based on the Morgan sale. We set it aside because there was no substantial proof of the values of the two interests in land transferred in partial payment of the Morgan property. If evidence of a prior sale involving an exchange of lands is to be considered as proof of present valuation, the values of such exchanged lands obviously must be proved by the same standards as attends proof of value of the property being condemned. Then it becomes the task of the trial judge to determine ordinarily whether such collateral issues would be so confusing or so lengthy as

to cause him to rule out any effort to prove value of the condemned tract in such a fashion.

We do not mean that if the government introduces the Morgan contract the condemnees may not reply to it, even by showing the inconsistency discussed above. We do hold that the unsupported statement that they considered the property worth over $900,000 in 1955 rather than the option price can be considered only in rebutting the option figure and not as affirmative proof of a higher value.

As we have pointed out, it was the Morgan sale at the claimed value of $977,266.47 that the commissioners used as the basis of their award. In their findings, however, they stated that they had considered and weighed all the other testimony. As pointed out above, they made specific findings of the loss to the condemnees of $996,670.91 by a process of capitalizing the net income projected over the economic life of the improvements and of $1,062,607.75 by capitalizing the same income by a process of excluding federal income taxes. We find that neither of these findings is remotely supported by any evidence in the record.

As to the first figure, the finding of fact is based on conclusions which we have quoted above. It shows that the commissioners found the economic life of the properties to be a total of 50 years—that is 7 years that have already passed, and 43 years for the future. This finding of fact is amply supported by the evidence and we cannot set it aside as clearly erroneous. The commissioners also found that the owner's potential net

gain for the 43 year period, according to the testimony and books and records in evidence, would be $6,615,341.38. The total net income figure varied widely in the testimony of the several witnesses. Some of the witnesses testified that the total income must be reduced by the cash reserves on hand at the time of taking, because they were necessary for replacement of equipment.

The figure arrived at by the commissioners would much better have been supported by subsidiary findings of fact. At least a finding as to the need for replacing the cash reserves for depreciation for short-lived equipment would have been almost essential to an understanding of the figure. Without adequate subsidiary findings it is impossible for this Court to test the correctness of the elements of which it is the product or the sum. See *United States v. Buhler*, 5 Cir., 254 F. 2d 876, 882. Moreover, the commissioners erred in assuming that the total would have been received in one lump sum at the end of the 43 years. It is perfectly clear from the record that any computation based on such assumption would be erroneous, since the rentals are payable over the life of the lease.

The next conclusion that the proper interest rate at which to capitalize such future income is 4½% is utterly without support. The lowest such figure testified to by witnesses introduced by the condemnees was a rate of 6%. It is not clear from the record that this figure was based on a proper hypothesis. Moreover, the explanation given by the commission that the 4½% rate, used by it, represented the mortgage rate on F.H.A. mortgage of 4%, plus 1/2% for mortgage in-

surance, demonstrates that the use of the 4½% rate for the equity ownership borders on the ridiculous. We think that an appellate court is required to disregard a finding that an ordinary prudent investor would be as willing to invest his money in an equity in F.H.A. controlled low rent housing on leased land, with all the hazards of occupancy and of continued uninterrupted maintenance of the military installation, as he would in a first mortgage on the same property absolutely guaranteed as to principal and interest by the United States government. As has aptly been said, "An equity in real estate is like a bumper on an automobile—it must take all the shocks first." Of course, such a finding must be disregarded here, in any event, because it was not supported by the testimony of a single witness.

The other findings, based on an assumption that a prospective purchaser would be a corporation that would "pay an income tax of 52% or would be an individual as to whom it is reasonable to assume that he would be a person of considerable wealth and income and that his income tax would equal or exceed the corporation rate of 52%," so far as we are able to find, are without precedent in any kind of valuation proceedings. Certain it is that the record contains no testimony touching either on these matters or on the fact that a rate of return of 2 3/4%, after deduction of 52% of the total net income "would be proper." This must also be disregarded.

Finally, objection was made by the United States during the hearings to the reception of evidence of the rate

of return on certain types of corporate securities and evidence that this equity would be "a conservative investment." There is no place in valuation proceedings for such testimony. For one to give an opinion on value he is ordinarily required to base such opinion on knowledge of sales at arm's length and without compulsion of comparable properties or on knowledge of the rate of return which the ordinary prudent investor requires in order to invest in a comparable project when he has complete freedom of choice.

Here the government introduced in evidence opinions based on sales of other Wherry housing projects. In view of the size of these projects and their potential attraction to others besides local investors, we have held that such sales are proper for consideration in such proceedings. *United States v. Benning Housing Corporation, supra.* So, too, were opinions based on the rate of return earned on the sales prices of large apartment properties with consideration given to the fact that the owners of this housing were not free to charge such rents as the traffic might bear. Opinions based on such information fits within the language of the Benning Housing Corporation case, in which we said: "Valuation such as this must be found on the basis of comparable sales, capitalization of income and original cost." Clearly "capitalization of income" comprehends the use of a rate of return in comparable investments. Evidence of rate of return that is in no way related to a comparable investment does not meet this requirement.

The absence of any conclusion of value supported by competent evidence in the record requires that the judgment of the trial court be set aside.

Although we would not consider it necessary to reverse the judgment solely because of the submission of this case to commissioners, if it were not necessary to reverse the judgment on the merits, we do conclude that on the record it was error for the trial court to make such reference.

In the Buhler case we clearly stated that such references are the exception and not the rule.

Rule 71(a)(h), F.R.C.P. provides:

> ". . . Any party may have a trial by jury of the issue of just compensation . . . unless the court in its discretion orders that, because of the character, location, or quantity of the property to be condemned, or for other reasons in the interest of justice, the issue of compensation shall be determined by a commission of three persons appointed by it . . . . ."

In construing the rule we stated in the Buhler case:

> ". . . as prescribing trial by jury as the usual and customary procedure to be followed, if demanded, in fixing the value of property taken in condemnation proceedings, and as authorizing reference to Commissioners only in cases wherein the judge in the exercise of a sound discretion based upon reasons appearing in the case finds that the interests of justice so require."

Here the government, as plaintiff, made a jury demand. The court, on its own motion, appointed the commissioners, citing as reason therefor only "because of the character, location and quantity of the land and improvements

being condemned." Thereupon the United States filed a motion to revoke the reference and to submit the case to a jury. After a hearing on this motion the statements of the trial court indicate that it considered the large number of rental units and the variety of other improvements made the valuation of these leaseholds a complex problem, because, as he said, "you have several million dollars worth of property with several hundred houses of different types and character, you have different rentals, you have a town in itself.": However, the court did not make any finding of fact as a basis for his conclusion that either the character, location, or quantity or for any other reason "in the interest of justice" this condemnation proceeding should fall in the exceptional class to be taken from a jury.

At the time of the reference this Court had not decided that reproduction cost less depreciation was not a relevant consideration in arriving at value, *Fort Benning Housing Corp. v. United States, supra.* In the Fort Benning case the trial judge admitted evidence of reconstruction cost, and the condemnees here introduced such evidence, although the commissioners did not act upon it. If such costs and the rates of depreciation applying to each type of improvement were relevant facts to be considered in such a case, it is less difficult to see why the trial court here felt the property to be of such a character as to warrant submission to commissioners. With the question of reproduction cost and depreciation out of the case, it is evident that there was nothing in this record that would warrant referring this condemnation case to commissioners. There was in effect a single 124-acre community

wholly within the Fort Bliss military reservation. There was no question of highest and best use, since the nature of the improvements was fixed for the life of the lease. It could be used for nothing but what it was now dedicated to. Proof of value must be of three kinds: (1) The cost of the project—a single total figure easily testified to before a jury; (2) capitalization of anticipated income—The anticipated income would necessarily be based on actual experience, one easily proved by an annual figure of gross rentals less expenses of operation and less carrying charges for mortgage payments multiplied by the anticipated life; it would make no difference whether such gross rents came from 200 two-family houses or 400 one-family houses because it is the dollar figure alone that is to be computed and then valued as of the date of taking, using a correct rate of return in making the computation; (3) proof of comparable sales is made by evidence of the sales price of property "considered" or "judged" to be comparable. It is traditional that the question whether the compared property is truly comparable is for the judge to decide. Once he decides the property is comparable enough to support the witness's opinion, it becomes the duty of the fact finder to weigh the opinion against that of others.

The failure of the commissioners here to comprehend the true nature of their duties, as evidenced by their departure from known and accepted standards of valuation and their complete failure to recognize and apply rules of evidence during the hearing, making it impossible for the trial court or this Court to determine whether its findings were based on legally admissible evidence, and its

failure to make adequate subsidiary findings of fact emphasize the reason for the rule that reference to a commission is the exception and not the rule.

A jury trial at which the trial judge promptly rules on the admissibility of proffered testimony and then narrows the issue by appropriate charge to the jury may, indeed, frequently simplify even what appears to be a complex valuation problem.

Since the issue of value of this single tract of land is easily manageable by presentation of testimony of cost, opinion evidence of what is a fair rate of return on factually provable net income, and combined factual and opinion evidence as to comparable sales, if any, this is not such a case as warranted submission to a commission under Rule 71(A)(h). *United States v. Theimer*, 10 Cir., 199 F. 2d 501.

The findings of value of the trial court, based as they were on an acceptance of findings and conclusions of the commissioners, are not supported by substantial evidence and they are, therefore, clearly erroneous. They are reversed and the case is remanded for trial in the conventional form by a jury.

REVERSED and REMANDED.

APPENDIX B

Opinions in Wherry condemnation cases (except those opinions involving sufficiency of deposit of compensation made by condemnor):

United States v. Chanute Gardens, 271 F. 2d 379 (7th Circuit, 165 F. Supp. 474, E. D. Illinois)

United States v. Benning Housing, 276 F. 2d 248 (5th Circuit 1960)

Buena Vista Homes v. United States, 281 F. 2d 476 (10th Circuit, 1960)

United States v. Johnson, 285 F. 2d 35 (9th Circuit, 1960)

United States v. Corbetta-Price, 176 F. Supp. 603 (N. D. Illinois, E. D.)

United States v. Likens-Foster Monterrey, 186 F. Supp. 167 (N. D. California, S. D.)

United States v. Ft. Bragg Investment, 185 F. Supp 555 (E. D. North Carolina)

APPENDIX C

JUDGMENT.

Extract from the Minutes of January 23, 1961.

UNITED STATES OF AMERICA,

versus

LEAVELL & PONDER, INC.,
AND MORGAN COMPANY, INC.

18427

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel:

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the said District Court for trial in the conventional form by a jury.

APPENDIX D

The jurisdiction of the Trial Court was invoked under Acts of Congress alleged in Paragraph 2 of the Complaint filed by The United States, R. 4, as follows:

"2. The authority for the taking is in accordance with the following Acts of Congress: The Act of Congress approved February 26, 1931 (46 Stat. 1421, 40 U.S.C. 258a) and Acts supplementary thereto and amendatory thereof, and under the further authority of the Act of Congress approved August 1, 1888 (25 Stat. 357, 40 U.S.C. 257); the Act of Congress approved August 10, 1956 (Public Law 1028, 84th Congress, 2d Session; 10 U.S.C. 2663), which authorize the acquisition of land for military purposes, and the Act of Congress approved August 7, 1956 (Public Law 1020, 84th Congress, 2d Session), as amended by the Act of Congress approved July 12, 1957 (Public Law 85-104), which authorized the acquisition and made funds available for such purposes."

APPENDIX E

12 U.S.C.A. 1748 (Definitions); 1748a (Expenses of Operation); 1748b:

In order to assist in relieving the acute shortage and urgent need for family housing which now exists at or in areas adjacent to military installations because of uncertainty as to the permanency of such installations and to increase the supply of necessary family housing accomodations for personnel at such installations, the Commissioner is authorized, upon application of the mortgagee, to insure mortgages (including advances on such mortgages during construction) which are eligible for insurance as hereinafter provided, and, upon such terms as the Commissioner may prescribe, to make commitments for so insuring such mortgages prior to the date of their execution or disbursement thereon:

Provided, That the aggregate amount of principal obligations of all mortgages insured under this subchapter (except mortgages insured pursuant to the provisions of this subchapter in effect prior to August 11, 1955) shall not exceed $2,300,000,000: **And provided further,** That the limitation in section 1715h of this title shall not apply to this subchapter: **And provided further,** That no mortgage shall be insured under this subchapter after June 30, 1958, except pursuant to a commitment to insure issued before such date.

* * * * *

42 U.S.C.A. 1594a:

Whenever the Secretary of Defense or his designee deems it necessary for the purpose of this subchapter he may acquire by purchase, donation, condemnation, or other means of transfer, any land or (with the ap-

proval of the Federal Housing Commissioner) any housing financed with mortgages insured under the provisions of sections 1748-1748h of Title 12 as in effect prior to August 11, 1955. The purchase price of any such housing shall not exceed the Federal Housing Commissioner's estimate of the replacement cost of such housing and related property (not including the value of any improvements installed or constructed with appropriated funds) as of the date of final endorsement for mortgage insurance reduced by an appropriate allowance for physical depreciation, as determined by the Secretary of Defense or his designee upon the advice of the Commissioner: **Provided,** That in any case where the Secretary or his designee acquires a project held by the Commissioner, the price paid shall not exceed the face value of the debentures (plus accrued interest thereon) which the Commissioner issued in acquiring such project.

* * * * *

42 U.S.C.A. 1594c(1) (as amended August 10, 1959):

Condemnation proceedings instituted pursuant to this section shall be conducted in accordance with the provisions of section 257 of Title 40, or any other applicable Federal statute. Before any such condemnation proceedings are instituted, an effort shall be made to acquire the property involved by negotiation. In any such condemnation proceedings, and in the interests of expedition, the issue of just compensation may be determined by a commission of three qualified, disinterested persons to be appointed by the court. Any commission appointed hereunder shall give full consideration to all elements of value in accordance with existing law, and shall have the powers of a master provided in subdivision (c) of rule 53 of the Federal Rules of Civil Procedure and proceedings before it shall be governed by the provisions of paragraphs (1) and (2) of subdivision (d) of such rule. Its action and report shall be determined by a majority and its findings and report shall have the effect, and be dealt with by the court in accordance with the practice prescribed in paragraph (2) of subdivision (e) of such rule. Trial of all issues, other than just compensation, shall be by the court.

* * * * *